# THE FINANCIERING OF TRUSTS.

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The subject that I have been asked to present—"The Financiering of Trusts"—is one as to which there is, probably, much confusion in the minds of many people. But it is so simple and the process is so obviously the one that must be followed that I am doubtful if I can worthily take any of your time.

The motives and the processes which produce a cheese factory or creamery are much the same as those which produce other business combinations or so called trusts. A, B, C, D, and E own dairy farms; they become satisfied in some way that they can manufacture and sell butter and cheese at greater advantage if they combine both for manufacture and sale than they can if they continue in the old way on each individual farm.

They may reach this conclusion through the talk of some man who wishes the job of managing the manufactory or by talk among themselves. In the one case there is a promoter; in the other not.

But coming to my immediate subject, owing to the fact that usually the things which we have in mind now are made by the union, under a new corporation, of private concerns and of corporations more or less widely separated geographically, and because there are laws about corporations that must be complied with or evaded, some things are done in their financiering which make apparent differences between them and the familiar cases of which I have spoken. But the difference is more apparent than real, as will appear when both are well understood.

Several manufacturers whose factories are in as many different places come to believe that it is for their advantage to unite their various businesses: they consult as to the value of their respective real estate, tools, machinery and business connections; then they organize a corporation under some state where the laws are suitable for their purpose, providing for a maximum of securities of various kinds, mortgage bonds, preferred and common stock—all or any of these as they may determine—and then sell their properties to the new corporation, taking in payment the securities of the new corporation in such proportions as the value of each property is to the value of all of them.

Or in another case the promoter acts. He goes to each of the manufacturers, obtains an option upon their properties, agreeing to pay for the same, it may be in cash or in the securities of the new corporation, or partly in cash and partly in securities. He organizes his company and agrees to sell the properties upon which he has his options to the new corporation for all the securities that it has issued. He then distributes part of these securities to those who have agreed to take them in payment for their properties, and sells to outsiders—new men—generally called "the public," another part of the new securities for cash, which is used to pay the money to those manufacturers who have agreed to take money in whole or in part, and also an agreed part of the cash thus realized is kept in the treasury of the new corporation as a working capital to avoid the necessity of selling the paper of the new company, as probably all of the concerns thus combined had been obliged to do before the combination was made. This provision of cash for working capital is also generally made in whatever way the combination

be brought about; it is certainly always done if good judgment and prudence have been respected in the formation of the combination. In many cases, I think it may be said, that one of the strong indncements which have caused manufacturers to enter into these combinations has been that they might be freed from the worry and peril of constantly raising money on their business paper to carry on a business which was not equipped with sufficient cash capital.

After enough of the securities have been distributed and sold to fulfill the engagements of the promoter, he tries to have a good supply left in his hands to reimburse him for his expenses and pay him for his time and labor. In some instances this pay is said to have been very large. Naturally as to this I have no positive knowledge in any instance, only rumor and gossip. This method of payment is the same as that of the reorganizers of railroad and other concerns; it is in the nature of a lawyer's contingent fee, dependent upon the success of the undertaking or suit, and is naturally larger than it would be if made in cash.

During the processes which I have described, underwriting syndicates have probably been employed to make sure that a sufficient amount of securities shall be sold to secure the cash needed, and there have been one or more bankers who may have loaned money needed, pending the final launching of the new company and may also have been employed to bring out its securities, *i. e.*, offer them for subscription by the public. Syndicates and bankers must be paid their commissions out of the surplus securities.

Perhaps a concrete illustration may help toward a clearer understanding of just how this part of the financiering of these combinations is managed. Let us

assume that the promoter has secured options upon the plants, assets and good will of ten separate manufacturing concerns, for which he is to pay, under the terms of his options, \$3,000,000 in cash and \$6,000,000 in preferred stock and \$4,000,000 in common stock of a new company of \$20,000,000 capital (half preferred stock) to be formed to acquire the entire plants, stock and other assets, good will, etc., of the ten concerns specified, and to have when formed at least \$1,000,000 of working capital. As soon as these options are in this definite shape the promoter goes to some financial house or firm of private bankers for assistance in raising the \$4,000,000 of cash which the plan requires. He presents the facts as to his options and his program and proposes that if they will arrange a syndicate to underwrite or guarantee the purchase of \$4,000,000 of preferred stock and \$4,000,000 common stock for \$4,000,000 in cash he will give them a commission of 5,000 shares of the common stock of the company. The bankers give the entire project careful investigation, usually employing experts and accountants to report upon the facts as to the business and profits of the constituent companies. If the result is satisfactory, the promoter gets a favorable answer and the bankers become the managers of an underwriting syndicate. In carrying out this part of the program they proceed to lay the matter before the individuals or companies to whom they desire to offer an interest in the marketing of the stock. This is naturally done by submitting copies of a syndicate agreement reciting that the subscribers agree to purchase at par the number of shares of preferred stock set opposite their respective names, receiving as a bonus an equal amount of common stock—but the whole conditioned upon there being an aggregate subscription

equal to the $4,000,000 to be raised. If this amount is oversubscribed some subscriptions are either thrown out or cut down. If it is not subscribed the project has to be abandoned or modified. In some cases the desired end is sought by a public announcement of the terms on which subscriptions will be received.

If the entire $4,000,000 is subscribed the next step is to require the payment of the subscriptions allotted. This gives the syndicate managers the $4,000,000 cash which the plan requires. The new company is then incorporated with an authorized capital of $10,000,000 preferred and $10,000,000 common stock, of which perhaps $5,000 of the common stock is paid up at once; and on this the company begins business with a regular board of directors. The stockholders owning this first $5,000 of stock (50 shares) then vote to authorize the increase of the capital to the amount fixed in the certificate of incorporation and approve the issue of all the additional stock in a block to John Doe, the promoter, in exchange for the various plants, assets, etc., and the $1,000,000 cash which the new company was to acquire. Then by simultaneous transactions John Doe gets the $10,000,000 preferred stock and $9,995,000 common stock; of this $6,000,000 of the preferred and $4,000,000 of the common stock is passed on to the owners of the original companies; $4,000,000 of each is passed to the syndicate, whereupon it turns over to John Doe the $4,000,000 of cash, which he in turn uses to pay the cash required by the options and that which is to go into the treasury of the new company; at the same time the titles to the various properties are passed to the new company. John Doe then finds himself—after turning over to the banking house which formed the syndicate the 5,000 shares of common stock agreed

upon as commission for their services—the possessor of 14,950 shares of common stock, of the par value of $1,495,000.

In planning the details of the various consolidations there has been great diversity. In some cases there has been only a single kind of stock—common stock. Such, for example, are the Standard Oil Co. and the Amalgamated Copper Co.—both among the largest of the so-called trusts. In most cases, however, there have been two kinds of stock, preferred and common—frequently evenly divided in amount between the two. When put out to the public through a syndicate, the preferred stock has usually been offered at par with a bonus of an equal amount, or 60 per cent., 75 per cent., or 80 per cent., in common stock. In the terms on which the preferred stock is issued, there is equal diversity. So far as one can generalize, it might perhaps be said that the most general plan has been to issue a 6 per cent. or 7 per cent. preferred stock, preferred not only as to dividend named, but as to assets as well. In some cases the position of the preferred stock has been made exceptionally strong. Take, for example, the preferred stock of the Royal Baking Powder Co. which, under the plan there followed, is allowed no voting power or representation in the management so long as the quarterly dividends of 6 per cent. per annum are regularly and promptly paid. But if there should be a default in the payment of that dividend, the entire voting power and management pass from the common to the preferred stockholders. This provision thus leaves the preferred stockholders in much the same position as if their interest was represented by bonds—but without the difficulty, expense and delay of foreclosure in case of default in payment of interest.

In the most of the recent consolidations there has been included no bonded debt. This I believe to be wise, inasmuch as it leaves the company with no fixed charges and thus in a much stronger position in a period of depression than it would occupy if it were obliged to meet the interest on a large amount of bonds. Because of this infrequent use of bonds in the consolidations which have been made in the industrial field, the first long continued period of depression will not produce the abundant crop of reorganizations that has in the past attended depression in the railroad field.

In the issue of common and preferred stocks in the capitalization of the corporations we are considering, an attempt has frequently been made to limit the preferred stock to the value of the actual tangible assets turned over to the new company, real estate, plants, tools, machinery, stocks of goods, working capital, etc., leaving the common stock to cover the value of the "goodwill," expected earnings, expenses of promotion, etc. This brings up a question which is of much importance to those who invest in the new company's stock, viz. "In what manner has the value of this 'goodwill' been estimated in fixing a price upon the various constituent companies?" Nearly every proposition for a consolidation has been accompanied by the results of a careful investigation into the net earnings of the constituent companies for a number of years past. These earnings augmented, perhaps, by an estimate of the economies to be effected by the consolidation of the various enterprises form the basis of the estimated net earnings of the new company. Care is then taken that the capital stock is not made so large that the estimated earnings will not afford the dividend upon the preferred stock and a substantial dividend upon the common stock.

In some cases the value of the goodwill acquired has been very carefully estimated. For example, the promoters of one company made a special point of the conservative methods employed in arriving at the value of the goodwill of the companies which were consolidated. According to their statement, the new company was virtually buying the real estate, plants, stock, etc., on the basis of appraised cash value. In addition an allowance was made for goodwill, calculated upon this basis; from the net profits of each company deduct 7 per cent. upon the capital actually employed, 1½ per cent. upon sales, which were about three times the capital, 2 per cent. for depreciation on brick buildings, 4 per cent. on frame buildings, and 8 per cent. on machinery. If the average net earnings were in excess of all this, and in this case it appeared from the promotor's statement that they usually were, the excess was capitalized as "goodwill" on the basis of 20 per cent. per annum, *i. e.*, the value of the goodwill was estimated to be five times the amount of such earnings in excess of 7 per cent. on capital and allowance for depreciation.

In some cases, however, there has not even been a pretext that the capitalization was based upon a careful investigation of the actual earnings of the constituent companies. I have in mind a certain consolidation which it was desired to effect. The promoters and the brokers who attempted to bring it out, however, in their prospectuses carefully avoided the subject of actual net earnings of the constituent companies, but based the estimate of earnings of the new company upon nothing more reliable than the quantity of product annually turned out and an estimate that the selling price had been and would be about twice the cost of producing the article. It is hardly to be

wondered at that the project was not sufficiently attractive to enlist the necessary investment support.

Many of these large industrial corporations have been formed to purchase, not the actual plants and assets, but the whole or a large part of the stock of the constituent companies. This stock even when the whole is owned by the new corporation, is then kept alive and constitutes the formal assets of the new company.

I might describe all the steps taken in the formation of the corporation were there time; but it is only what is done in the formation of a corporation for any purpose, and, while interesting, does not belong especially to this subject.

I have a table of the kinds and amounts of the securities used by some of the more important of the 200 or 300 corporations of this nature that have been formed within the past few years; but there is not time, nor would it be worth while, to read them now. They will be attached hereto, however, as an appendix.

All this that I have described which is in excess of what is done in the formation of the cheese manufacturing combination is rendered necessary either by the state laws governing corporations or by the need of raising cash capital, or to enable the constituent members of the corporation to conveniently collect their profits from the combined business in proper proportions and to have a representation of their interests therein which is divided in such form as to enable portions of it to be sold or transmitted to heirs, etc., etc.

In substance, however, there is no difference. The milk delivered morning and evening during the year is each farmer's contribution to the combination; his interest in the whole varies according to both quality and quantity of milk, just as in the other combinations

the interests vary according to the quality and quantity of property and goodwill or business contributed by each. Just as a creamery will be successful as it is well or badly managed, or as is the market for its products, so in like proportion will any other business combination succeed, and for like causes.

The larger combinations, however, through their securities affect financial matters generally to a greater or less extent as they come into the stock market and into the field of investment and speculation. Naturally the uncertainty as to amount and regularity of profits attendant upon one of these enterprises while it is new will make its securities a fruitful object of speculation. Time and experience will sift them and cause each one to take its proper place in the share list. All other business securities, be they railroad, telegraph, bank stocks or what not, have and must go through a like sifting and settling process and their values are and will be constantly changing. Some of the other industrials, as they are called, have come to be as regular in their dividends and as stable in price as the best railroad stocks, and some of them are much more removed from the speculative field.

As to the effect upon the money market of these new securities, it is hard to say. It must be remembered that the great bulk of them are in the hands of the owners of the original constituent properties. It must also be remembered that the cash capital provided upon the formation of the new corporation has taken from the money market a large amount of industrial commercial paper; in its place is the borrowing upon the securities of the new corporations. As to what proportion the one bears to the other, there are no data to be had. At a venture, however, I would say that there is

little, if any, more money loaned now upon the shares of new industrial combinations than there would be now loaned upon the business paper of the constituent concerns had the combinations not been formed. Of course I say this bearing in mind the demand for money accommodation that would have been caused by the present business and manufacturing activity. Probably the places where the loans are made have been changed. More comes upon New York and the business centres, and less upon the banks in the places where the separate factories are. This may partially account for the greater money pressure in New York with comparative ease in the interior. All of this will, however, soon adjust itself by the aid of the rapid communication given by railroads and telegraphs and the business world will move on with certainly no more rapid changes up and down in the future than in the past. In the meantime prudence and judgment must be used that the unworthy may not have undue opportunities and also that the worthy may not be unduly repressed. A great help and safeguard would be some well devised plan of publicity as to corporate earnings and expenses. Such plan would serve the financial and general business public and at the same time would be a great assistance to the solid and well conducted business combination.

# APPENDIX.

## CAPITALIZATION OF SOME OF THE MORE IMPORTANT INDUSTRIAL "TRUSTS."

| | | Preferred Stock. | | | Bonds. | |
|---|---|---|---|---|---|---|
| | Common Stock. | Amount. | Rate. | Character. | Amount. | Rate. |
| *Common Stock only:* | | | | | | |
| Amalgamated Copper Co. | $75,000,000 | ---- | ---- | ---- | ---- | ---- |
| Diamond Match Co. | 15,000,000 | ---- | ---- | ---- | ---- | ---- |
| Standard Oil Company of N. J. | 100,000,000 | ---- | ---- | ---- | ---- | ---- |
| *Preferred and Common Stock:* | | | | | | |
| American Agricultural Chemical Co. | 16,500,000 | $16,500,000 | 6 | C. A. | ---- | ---- |
| American Beet Sugar Co. | 15,000,000 | 4,000,000 | 6 | NC. | ---- | ---- |
| American Brick Co. | 7,500,000 | 7,500,000 | 7 | NC. | ---- | ---- |
| American Bridge Co. | 34,500,000 | 23,000,000 | 7 | CA. | ---- | ---- |
| American Car and Foundry Co. | 29,090,000 | 29,090,000 | 7 | NC. A. | ---- | ---- |
| American Chicle Co. (chewing gum) | 6,000,000 | 3,000,000 | 6 | C. | ---- | ---- |
| American Ice Co. | 22,939,100 | 12,440,400 | 6 | C. | ---- | ---- |
| American Linseed Oil Co. | 15,475,000 | 15,475,000 | 7 | NC. | ---- | ---- |
| American Malting Co. | 14,500,000 | 14,440,000 | 7 | C. | ---- | ---- |
| American Radiator Co. | 5,000,000 | 3,000,000 | 7 | C. | ---- | ---- |
| American Smelting and Refining Co. | 27,400,000 | 27,400,000 | 7 | C. | ---- | ---- |
| American Steel Hoop Co. | 19,000,000 | 14,000,000 | 7 | C. A. | ---- | ---- |
| American Steel and Wire Co. | 50,000,000 | 40,000,000 | 7 | C. | ---- | ---- |
| American Sugar Refining Co. | 36,968,000 | 36,968,000 | 7 | C. | ---- | ---- |
| American Tin Plate Co. | 28,000,000 | 18,000,000 | 7 | C. | ---- | ---- |
| American Tobacco Co. | 54,500,000 | 14,000,000 | 8 | NC. A. | ---- | ---- |
| American Window Glass Co. | 13,000,000 | 4,000,000 | 7 | C. | ---- | ---- |
| American Woolen Co. | 29,501,100 | 20,000,000 | 7 | C. | ---- | ---- |

| | Common Stock. | Preferred Stock. Amount. | Preferred Stock. Rate. | Preferred Stock. Character. | Bonds. Amount. | Bonds. Rate. |
|---|---|---|---|---|---|---|
| Continental Tobacco Co. | $48,846,100 | $48,844,600 | 7 | NC. A. | ---- | ---- |
| Distilling Company of America | 46,250,000 | 31,250,000 | 7 | C. | ---- | ---- |
| General Chemical Company | 12,500,000 | 12,500,000 | 6 | C. | ---- | ---- |
| Glucose Sugar Refining Co | 24,027,300 | 12,619,300 | 7 | C. | ---- | ---- |
| Havana Commercial Co. | 10,000,000 | 6,000,000 | 7 | C. | ---- | ---- |
| International Car Wheel Co. | 3,225,000 | 1,775,000 | 7 | CA. | ---- | ---- |
| International Power Co. | 7,400,000 | 600,000 | 3 | C. | ---- | ---- |
| International Steam Pump Co. | 15,000,000 | 8,850,000 | 6 | C. | ---- | ---- |
| National Biscuit Co. | 29,200,000 | 23,200,000 | 7 | C. | ---- | ---- |
| National Lead Co. | 14,905,400 | 14,904,000 | 7 | C. | ---- | ---- |
| National Salt Co. | 3,500,000 | 2,400,000 | 7 | NC. | ---- | ---- |
| National Steel Co. | 32,000,000 | 27,000,000 | 7 | C. A. | ---- | ---- |
| National Tube Co. | 40,000,000 | 40,000,000 | 7 | C. | ---- | ---- |
| National Wall Paper Co. | 27,931,500 | 7,500,000 | 8 | Debenture Stock. | | ---- |
| Otis Elevator Co. | 6,000,000 | 4,000,000 | 6 | NC. | ---- | ---- |
| Republic Iron and Steel Co. | 27,352,000 | 20,852,000 | 7 | CA. | ---- | ---- |
| Royal Baking Powder Co. | 10,000,000 | 10,000,000 | 6 | CA. | ---- | ---- |
| Rubber Goods Manufacturing Co. | 12,114,900 | 6,336,900 | 7 | C. | ---- | ---- |
| Union Bag and Paper Co. | 16,000,000 | 11,000,000 | 7 | CA. | ---- | ---- |
| Union Typewriter Co. | 10,000,000 | (1st) 4,000,000 | 7 | C. | ---- | ---- |
| | | (2d) 4,015,000 | 8 | C. | ---- | ---- |
| United Shoe Machinery Co. | 8,660,725 | 8,657,700 | 6 | C. | ---- | ---- |
| United States Rubber Co. | 23,666,000 | 23,525,500 | 8 | NC. A. | ---- | ---- |
| *Stock and Bonds:* | | | | | | |
| American Bicycle Co. | 20,000,000 | 10,000,000 | 7 | C. | 10,000,000 | 5 |
| American Cotton Oil Co. | 20,237,000 | 10,198,600 | 6 | NC. | 3,068,000 | 8 |
| American Hide and Leather Co. | 11,500,000 | 13,000,000 | 7 | CA. | 8,445,000 | 6 |
| American Writing Paper Co. | $ 9,500,000 | $12,500,000 | 7 | CA. | 17,000,000 | 5 |
| American Thread Co. | 6,000,000 | 6,000,000 | 5 | ---- | 6,000,000 | 4 |

| | Common Stock. | Preferred Stock. Amount. | Preferred Stock. Rate. | Preferred Stock. Character. | Bonds. Amount | Bonds. Rate. |
|---|---|---|---|---|---|---|
| Asphalt Company of America | 30,000,000 | ---------- | -- | ------- | 30,000,000 | 5 |
| Central Foundry Co. | 7,000,000 | 7,000,000 | 7 | C. | 4,000,000 | 6 |
| Federal Steel Co. | 46,484,300 | 53,261,000 | 6 | NC. A. | 28,334,000 | 5 |
| International Paper Co. | 17,442,800 | 22,406,700 | 6 | C. | 8,782,000 | 6 |
| International Silver Co. | 9,946,000 | 5,111,500 | 7 | C. | 3,592,000 | 6 |
| Mt. Vernon—Woodbury Cotton Duck Co. | 9,500,000 | ---------- | -- | ------- | 7,000,000<br>6,000,000 Inc. | 6<br>5 |
| National Starch Manufacturing Co. | 4,450,700 | (1st) 2,219,400 | 8 | CA. | 3,042,000 | 6 |
| | | (2d) 1,846,800 | 12 | CA. | 5,700,000 | 5 |
| New England Cotton Yarn Co. | 5,000,000 | 5,000,000 | 7 | CA. | 2,878,000<br>7,500,000 Inc. | 6<br>5 |
| Standard Rope and Twine Co. | 12,000,000 | ---------- | -- | ------- | | |
| United States Envelope Co. | 750,000 | 3,750,000 | 7 | C. | 2,000,000 | 6 |
| United States Flour Milling Co. | 3,500,000 | 5,000,000 | 6 | C. | 7,500,000 | 6 |
| United States Leather Co. | 62,854,600 | 62,254,600 | 8 | C. | 5,280,000 | 6 |

C = Cumulative.

NC = Non-cumulative.

A = Preferred as to assets as well as dividends.

Inc = Income bonds.